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IN THE

Supreme Court of the United States

October Term, 1940

No. 648

MANUEL V. DOMENECH, TREASURER,
Petitioner,

vs.

SAN JUAN TRADING COMPANY, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, FIRST CIRCUIT, AND SUPPORTING BRIEF

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PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS, FIRST CIRCUIT.

To the Honorable, the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

Petitioner, Manuel V. Domenech, Treasurer of Puerto Rico, prays a writ of certiorari to review the judgments of the Circuit Court of Appeals for the First Circuit, October 16, 1940 [114 F. (2d) 969, *Advance Sheets*], affirming [R. 63] the judgment[1] of the District Court of the United States for the District of Puerto Rico invalidating Subdivision 7 of Section 16 of the insular Internal Revenue Law, as amended in 1938, on several grounds, in-so-far as, in classifying matches for the purposes of the sales tax, with relation to the substantially revenue producing sales of the uncolored ones packed in the popular small wooden box, 25 to ~~10~~ 50 in a box, it differentiates between the square matches [cut from hardwood] and the round ones [punched out of soft wood] and places a

[1] Two appeals to the Circuit Court of Appeals (Nos. 3567 and 3568 there) by the opposing parties, from a single judgment of the District Court [R. 35-46; 50-51].

higher tax on sales of the former. [R. 43-47; *infra*, p. 3-6].

The decision of the Circuit Court of Appeals was by a divided court. Each of the three judges wrote a separate opinion. JUDGE MAHONEY considered [R. 47-59] the assailed legislation invalid upon all the grounds upon which it is attacked [except the alleged violation of "uniformity in taxation"]. He agreed in substance with the opinion [R. 18-34] of the District Court.

PRESIDING JUDGE MAGRUDER begins his opinion [R. 59-62] "With some misgivings, I concur in the result". He does not consider the legislation violative of the due process or equal protection clauses of the Organic Act for Puerto Rico [or of the Constitution], and he questions "whether the provisions of the reciprocal trade agreement with Sweden can be invoked by the present plaintiff, a Puerto Rican corporation", but he does think the legislation violative of "the spirit, and I think the letter" of the *proviso* added to section 3 of the Organic Act by the "Butler Act" of March 4, 1927 (44 Stat. 1418).

JUDGE PETERS, on the other hand, dissenting [R. 62], holds the insular legislation valid. He says:

> "I feel obliged to dissent from the conclusions of the majority of the court because I cannot find sufficient justification for invalidating the action of the Puerto Rican Legislature. I agree with Judge Magruder that there is no violation of Section 2 of the Organic Act, nor do I think the provisions of the Swedish Trade Agreement can be invoked.
>
> "As to Section 3 of the Organic Act, it seems to me that there is no violation. The classification made in the tax on matches appears to me to be reasonable, based, as it is, on differences in shape, method of manufacture and nature of the material; but, assuming that different minds may reasonably take different views on that point, I think the opinion of the Legislature should prevail.
>
> "The fact that the classification may be called

narrow does not, as I look at it, authorize us to say it should not be applied. Such discrimination as may result is incidental to the principal purpose of the Act which is the legitimate one of fostering home industries."

On a subsidiary question presented, all three of the judges of the Circuit Court of Appeals agree with the District Court that any invalidity of the greater rate of tax here involved extends only to the excess over the amount of the tax rate on other matches, and does not invalidate the entire tax as the respondent claims it does, but only the excess rate.

STATEMENT

JUDGE MAHONEY in his opinion in the Circuit Court of Appeals states the case as follows [R. 47-51]:

> "The plaintiff, the San Juan Trading Co., Inc., brought this action to recover from the Treasurer of Puerto Rico the sum of $26,400 paid under protest and collected as excise taxes due and levied upon 88,000 gross of 144 boxes each of uncolored square stick matches packed in wooden outers or shucks containing not less than 25 but not more than 50 sticks per box, brought by the plaintiff into Puerto Rico from the City and State of New York, to be disposed of in Puerto Rico. The said matches had originally been produced in Sweden and had been imported into the United States after August 5, 1935.
>
> The Treasurer levied and collected the tax under the provisions of subdivision 7 of Section 16 of Act No. 85, approved by the Legislature of Puerto Rico, August 20, 1925 (commonly known as the Internal Revenue Law of Puerto Rico) as amended by Act No. 146, approved May 9, 1938.[2] In substance, insofar

[2] Judge Mahoney here quotes in the margin to his opinion (R. 48) subdivision 7 of Section 16 of the Internal Revenue Law of Puerto Rico as amended by Act No. 146, May 9, 1938; Appendix hereto, *infra*, pp. 41-47.

as here relevant, the subsection taxes uncolored round stick matches (when packed in a wooden box containing not less than 25 nor more than 50 matches) at 10 cents per gross of 144 boxes while uncolored square stick matches packed in the same way are taxed at 30 cents per gross. Matches packed in other than wooden boxes, regardless of whether round or square, are taxed the same, a difference in taxation only being made dependent on whether the box contained not less than 25 nor more than 50 matches or whether it had less than 25 or more than 50. Paper or cardboard, wooden, and sperm or wax matches were also classified for different rates of taxation. By Act No. 14, approved September 9, 1938, the statute was amended to tax wooden matches, whether round or square, packed in wooden boxes containing less than 25 or more than 50 matches. These had been left untaxed in the previous Act.

Plaintiff and defendant stipulated that the only wooden matches produced in Puerto Rico are round stick matches made by the Pan American Match Company, a Puerto Rican corporation; that the only other round stick matches sold in Puerto Rico are made in the continental United States and recently in Sweden; that the round matches are die-cut from prepared blocks of soft "White Pine", whereas square matches are severed directly from sheets of hardwood known as "Aspen"; that the cost to Swedish manufacturers of producing round stick matches is at present greater than that of producing square stick matches, though it cannot be determined whether it will remain so; and that the retail price for both Swedish and Puerto Rican matches is one cent per box.

The plaintiff challenged the validity of subdivision 7 of Section 16, *supra*, on the grounds that by unwarrantedly discriminating between round and square matches, the subdivision violates the rights secured to the plaintiff by the V and XIV Amendments to the Constitution of the United States, and Section 2 (par. 1) of the Organic Act of Puerto Rico (39 Stat. 951 (1917)) in that it deprives the plaintiff of its property without due process of law and denies it the

equal protection of the laws; contravenes Article VI of the Reciprocal Commercial Trade Agreement entered into between the United States and the Kingdom of Sweden and signed May 25, 1935 (49 Stat. 3759) exempting imports from Sweden from internal revenue taxes other or higher than those payable on like articles of national or other foreign origin, and also violates the provisions of Section 2 (par. 22) of the Organic Act of Puerto Rico, *supra*, at page 952, to the effect that taxation in the Island shall be uniform, and the provisions of Section 3 thereof as amended (44 Stat. 1418 (1927)) that there must be no discrimination between articles imported from the United States or foreign countries and similar articles of domestic origin.

The defendant admitted levying and collecting the tax under the statute set out above but denied that the statute violated the Constitution of the United States, the Organic Act of Puerto Rico, or the Reciprocal Commercial Trade Agreement. He further alleged that round and square stick matches have different characteristics of a substantial nature sufficient to justify the Legislature of Puerto Rico in classifying them differently for purposes of taxation.

The case having been submitted on the pleadings and the stipulation, the District Court held that the classification which made a distinction between round and square matches was unreasonable in that it bore no substantial or fair relation to the object or purpose of a revenue act and that it violated the XIV Amendment of the Constitution of the United States, the Organic Act of Puerto Rico, and the Reciprocal Commercial Trade Agreement. It further held, however, that the invalidation of the discriminatory features of subdivision 7 of Section 16 did not void the entire section but only the amount of the invalid discrimination of 20 cents per gross. It, therefore, allowed the plaintiff a refund in that amount, and entered judgment in the sum of $17,600 with interest thereon from the date of filing of the suit to the date of payment.

From this judgment, both plaintiff and defendant appeal. The plaintiff alleges that the District Court

was in error in holding that it was subject to a tax of 10 cents per gross and in refusing to order a refund of the entire 30 cent tax collected from it. The defendant claims that the court erred in invalidating the said subdivision, asserting that the classification is reasonable; that the said subdivision does not violate the Constitution of the United States, the Organic Act of Puerto Rico, or the Reciprocal Commercial Trade Agreement, and that the District Court should not have allowed the plaintiff any refund whatever."

QUESTIONS PRESENTED

The important question here presented is of the power of the insular Legislature to encourage local manufacturing interests by a differentiation in the rates of the excise taxes in favor of the soft wood matches produced in Puerto Rico [and in the mainland of the United States] as well as [recently] in Sweden, as against the hard wood matches produced by a different manufacturing process solely in Sweden and imported into the mainland United States and shipped to Puerto Rico. The soft wood match is produced by punching it out of soft wood, which results in a round match. This process, with the machinery for it, appears to have been developed in the United States mainland and introduced into Puerto Rico, thus creating a manufacturing industry in the Island, where manufacturing industries are greatly needed, and where it has been the long-established policy of the Legislature to foster them because of the Island's great over-population and its excess of labor supply and lack of manufacturing industries.

The Swedish hard wood match, on the other hand, is produced by another process. It is made by stamping the matches out of thin sheets of hard wood veneer. That results in a square match. It appears that the Swedish manufacturers making this hard wood square match have not so far developed the machinery or process to enable

them to make a round match as cheaply as the square match; although it is stipulated [R. 18],

> "that such manufacturers can not now determine whether they will ultimately be able to produce round-stick matches at a cost not greater than that of producing square-stick matches".

In other words, the apparent effect of the excise tax differentiation in favor of the round [soft wood] match, as against the square match, is not to prevent competition by the Swedish manufacturers; but only to encourage them to change their processes, and to go into the process of manufacturing the round match, a form of industry in which the local Puerto Rican manufacturers may have a competitive opportunity; whereas, in the hard wood [square match] manufacturing field, the Swedish manufacturers enjoy a practical monopoly.

The ultimate question is therefore of the power of the Legislature of Puerto Rico so to exercise its powers of classification in local taxation as to give the local industry this competitive opportunity in the soft wood [round] match field, as against the practical monopoly enjoyed by the foreign manufacturers in the hard wood [square] match field.

The legislative background and policy is stated more at length in our Supporting Brief (*infra*, pp. 14-18).

As above indicated the legislation is assailed on several grounds: (1) As violating the guarantees of "due process" and "equal protection of the laws" and of "uniformity in taxation" of the Constitution and the Organic Act; (2) As violative of the *proviso* added to section 3 of the Organic Act by the "Butler Act" of Congress, March 4, 1927 (44 Stat. 1418, *Appendix, infra*, p. 41),

> "That no discrimination be made between the articles imported from the United States or foreign countries and similar articles produced or manufactured in Porto Rico";

and (3) As violative of the similar guarantee given by United States in the "Reciprocal Commercial Trade Agreement" with Sweden of May 25, 1925 (*Appendix, infra,* p. 55) which provides for the admission of Swedish products to the United States,

> "exempt from all internal taxes, fees, charges, or exactions, other or higher than those payable on like articles of national origin or any other foreign origin".

TREASURER'S POSITION

The Treasurer's position on behalf of the Government of Puerto Rico is that: (1) Such a classification of different types of manufacturing processes, for the purpose of encouraging the type of process that may successfully be carried on by local industry, is within the broad local legislative powers of the Legislature of Puerto Rico, and is not violative of the guarantees either of due process, of equal protection of the laws, or of uniformity in taxation; (2) That the *proviso,* added by the Butler Act to section 3 of the Organic Act, against "discrimination" between articles imported from the United States or foreign countries and *"similar articles"* produced or manufactured in Puerto Rico does not override the Legislature's power of classification among different types of articles or processes of manufacture, but that the word "similar" is only intended to refer to articles within the same classification in any group; (3) That the words *"like products," "like articles"* in the trade agreement with Sweden indicate no further restriction, but are practically synonymous with the words *"similar articles"* in the Butler Act; and, like those words, do not indicate any purpose on the part of the treaty making power to override the Legislature's general power of classification for tax purposes, but only to place the foreigner on a basis of exact equality with the United States citizen in relation to each classification; and (4) That, in any event, this plaintiff-

respondent, a domestic corporation of Puerto Rico, is not in position to invoke the protection of the trade agreement with a foreign country.

OPINIONS OF THE COURTS BELOW

As stated, the District Court overruled the Treasurer on all these points, and struck down the legislation on all these grounds [R. 18-32]. In the Circuit Court of Appeals JUDGE MAHONEY, agreeing with the District Court, likewise sustained [R. 47-57] the attack on all points, *except* the "uniformity in taxation" clause, which he does not consider violated [R. 52] "if the classification between round and square matches is valid"; whereas JUDGE MAGRUDER [R. 59-62] "With some misgivings" concurred only in the result, agreeing with the Treasurer that the tax classification here involved does not violate the guarantees of due process or the equal protection of the laws [without specifically referring to the requirement of "uniformity in taxation" which, however, it may be inferred from his opinion that he does not consider violated]; and he "questions" "whether the provisions of" the Swedish Trade Agreement "can be invoked by the present plaintiff, a Puerto Rican corporation"; but he does consider that the Butler Act *proviso* narrows the powers of the Legislature of Puerto Rico in classification for taxation more closely than do the requirements of "due process" or of "equal protection of the laws."

JUDGE PETERS, on the other hand, dissenting, as above quoted (R. 62; *ante*, pp. 2-3), holds the legislation within the power of the Legislature, and valid. He agrees with Judge Magruder that it is not violative of section 2 of the Organic Act [the "due process" and the "equal protection of the laws" and "uniformity in taxation" clauses], and that the Swedish Trade Agreement cannot be here invoked by this domestic corporation of Puerto Rico. But he disagrees with Judge Magruder [as well as with Judge Mahoney] as to the Butler Act *proviso*. He does

not consider that it further narrows the Legislature's powers of classification for taxation.

The Treasurer submits that Judge Peters' opinion is correct; that the legislation is valid; and that accordingly the decision should be reviewed by this Court, and that the judgments of the lower courts should be reversed.

STATUTES

The legislation here directly assailed, section 7 of section 16 of Act No. 85 of the Legislature of Puerto Rico, approved August 20, 1925, the "Internal Revenue Law of Puerto Rico" (Laws of 1925, p. 584) as amended by Act No. 146 approved May 9, 1938 (Laws of 1938, p. 325), and further by Act No. 14, September 9, 1938, is in the Appendix, *infra*, pp. 41-47; as are likewise other pertinent Constitutional and statutory provisions, federal and insular, including the pertinent portions of the trade agreement with Sweden (*Appendix, infra,* pp. 41, 47-55).

REASONS FOR GRANTING THE WRIT

This case presents important questions of federal law that have not been and it is believed should be decided by this Court. They are of particular importance to the Government and to the people of Puerto Rico in the development of manufacturing industries in that island Territory. The case likewise presents conflicts of opinion among the Judges of the Circuit Court of Appeals for the First Circuit, where each of the three Judges felt it his duty to write a separate opinion, and no two of them were in agreement on all the essential points. Furthermore, it is believed that the prevailing result and the decisions of the Circuit Court of Appeals, and of the District Court, are in conflict with applicable decisions of this Court as to the extent of the local legislative powers of the Legislature of Puerto Rico, particularly *People of Puerto Rico* vs. *Shell Co.*, 302 U. S. 253, 261, 262; *People*

of Puerto Rico vs. *Rubert Hermanos, Inc.*, 309 U. S. 543, 547; and *Bacardi Corporation of America* vs. *Domenech, Treasurer* [No. 21, decided December 9, 1940; United States Law Week for December 10, 1940, Vol. 9, pp. 4056, 4059]; and also such decisions as *Madden* vs. *Kentucky*, 309 U. S. 83, 88, as to the "freedom of classification" of the legislative power in matters of taxation; and *Cincinnati Soap Co.* vs. *United States*, 301 U. S. 308, 320, as to its power to lay taxes with a view to encouraging domestic industry; and that other decisions of this Court were misapplied, particularly [R. 57] *Bethlehem Motors Co.* vs. *Flynt*, 256 U. S. 421; *Brimmer* vs. *Rebman*, 138 U. S. 78; and *Minnesota* vs. *Barber*, 136 U. S. 313; as well as *Askren* vs. *Continental Oil Co.*, 252 U. S. 444, 450, and *Chalker* vs. *Birmingham & N. W. Ry. Co.*, 249 U. S. 522.

The following ultimate questions among those here presented are believed to be of particularly broad general importance:

(1) Whether, as JUDGE MAHONEY holds in effect in his separate opinion in the Circuit Court of Appeals [R. 51-56], the Legislature of Puerto Rico is without power under the "due process" clause to exercise its powers of classification in taxation for the encouragement of a type of manufacturing process adapted to develop local manufacturing industries in the Island, as against other processes not so adapted. As to this question, Judge Mahoney stands alone in the Circuit Court of Appeals. Both of the other Judges, Judges Magruder [R. 59] and Peters [R. 62] disagree with him here, and uphold the power of the Legislature so far as this question is concerned;—that is, so far as the "due process" and the "equal protection of the laws" as well as the "uniformity in taxation" clauses go.

(2) Whether, as JUDGES MAHONEY and MAGRUDER hold [R. 56; 60-62], the *proviso* added to section 3 of the

Organic Act by the Butler Act of 1927, forbidding discrimination between "similar articles" imported into the Island and those produced or manufactured there, further narrows the Legislature's powers of classification for taxation, so as to have the result that, as Judge Mahoney phrases it [R. 56, *supra*]:

> "A classification which would not be considered so unreasonable as to deny the equal protection of the laws can still be invalid"

under this *proviso* of the Butler Act. JUDGE PETERS does not agree with this [R. 62]; and this question does not appear to have been expressly considered by the District Court [R. 20-32].

(3) Can the Swedish Trade Agreement be availed of by a domestic corporation of Puerto Rico such as the plaintiff-respondent in this case? The District Court impliedly so held, without expressly discussing this question [R. 30-32], as did likewise JUDGE MAHONEY in the Circuit Court of Appeals [R. 54-55]; but on the other hand the majority of the Circuit Court judges, JUDGE MAGRUDER [R. 59] as well as JUDGE PETERS [R. 62], hold with the Treasurer on this point that the Trade Agreement cannot be invoked "by the present plaintiff, a Puerto Rican corporation".

(4) In any event [in case the plaintiff-respondent, a domestic corporation of Puerto Rico, were in position to invoke it here], does the phrase *"like products"* or *"like articles"* in the Swedish Trade Agreement further narrow the Legislature's powers of classification in taxation; or does it not, on the other hand, like the phrase *"similar articles"* in the Butler Act *proviso*, merely prevent discrimination within the same group of articles, and not affect the legislative power to classify articles or types of processes into groups for tax purposes.

It will be observed that the only question upon which any two of the judges of the Circuit Court of Appeals reached an

agreement adverse to the contentions of the Treasurer, this petitioner, and agreed that the legislation must be struck down, is the question numbered "(2)" above. Upon that point JUDGE MAGRUDER "with some misgivings" [R. 59, *supra*] concurred with JUDGE MAHONEY that the effect of the Butler Act *proviso* to section 3 of the Organic Act is so to narrow the Legislature's powers of classification for tax purposes that, as above quoted [R. 56, *supra*], "A classification which would not be considered so unreasonable as to deny the equal protection of the laws can still be invalid" under this Butler Act *proviso,* THAT IS THE ONLY POINT UPON WHICH THE LEGISLATION WAS STRUCK DOWN,— by the consenting majority of two Judges,—PRESIDING JUDGE MAGRUDER here agreeing with JUDGE MAHONEY, over the dissent of JUDGE PETERS.

On all the other points JUDGES MAGRUDER and PETERS agreed in rejecting the attacks, and upholding the legislation.

This one question of the interpretation of the Butler Act proviso to section 3 of the Organic Act is, therefore, the primary question in the case. It is an important question of Federal law which has not been and should be decided by this Court. It is believed that the majority opinion on this question is clearly wrong; and that this question, particularly, should be considered by this Court, as well as the other questions above indicated.

Wherefore, it is respectfully requested that this petition for a writ of certiorari be granted.

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